Q4 2018 | Putnam Multi-Asset Absolute Return Fund Q&A

Directional strategies weigh amid challenging macro backdrop

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Investor risk-aversion led to broad-based negative performance in the fourth quarter, although government-related bonds posted gains.

Directional strategies were the primary detractor from fund performance, but weakness there was partially offset by positive results from exposure to interest-rate risk.

As of December 31, we have a positive view toward commodities and are tactically bullish on stocks.

What was the fund's investment environment like during the fourth quarter of 2018?

The across-the-board flight from risk that occurred during the quarter made for a difficult backdrop. Despite some recovery during the last week of December, most markets posted negative returns for the quarter. Concern about slowing global economic growth and uncertainty about the ultimate resolution of a trade dispute between the United States and China weighed on investor sentiment the past three months.

The S&P 500 Index declined 13.5% for the quarter, and entered negative territory for the year, finishing down 4.4%. International developed and emerging markets held up better than U.S. markets during the fourth quarter, but lagged the United States for the full year. For 2018, the MSCI EAFE Index fell 13.8% and the MSCI Emerging Markets Index slumped 14.6%, in U.S.-dollar terms.

Credit-sensitive assets also declined as yield spreads widened. U.S. high-yield bonds underperformed emerging-market [EM] debt for the quarter, but returned –2.1% for the year, meaningfully ahead of the –5.3% result generated by EM debt on a U.S.-dollar basis.

U.S. Treasuries and other government securities were a bright spot in the fourth quarter. In response to investor risk-aversion, Treasuries finally provided some diversification benefit, as yields fell substantially and prices rose. The yield on the benchmark 10-year U.S. Treasury ended the year at 2.69% after trading above 3% early in the fourth quarter. Intermediate-maturity U.S. Treasuries delivered a total return of 3.7%, as measured by the ICE BofAML 7-10 Year U.S. Treasury Index, while the broad Bloomberg Barclays U.S. Aggregate Bond Index gained 1.64%. Foreign sovereign bonds also registered positive performance, with the FTSE World Government Bond Index returning 1.8% in U.S.-dollar terms.

A sharp decline in the price of oil hampered the performance of inflation-sensitive assets in the fourth quarter. U.S. crude prices fell 38% in the three months ended December 31, 2018, their biggest quarterly slide since the final months of 2014. Against this backdrop, the S&P GSCI Light Energy Index tumbled 12.1% for the quarter.

Before we discuss performance, would you summarize the fund's overall investment objective and strategy?

Putnam Multi-Asset Absolute Return Fund seeks a positive return exceeding the return of Treasury bills over a reasonable period of time, regardless of market conditions. The fund seeks to achieve risk-and-return characteristics by dynamically allocating assets using a combination of directional (or market sensitive) and non-directional (or market neutral) strategies. In addition, both the composition and total level of risk can be dynamically managed depending on market conditions and the prevailing opportunity set. The fund also employs strategies that may produce lower volatility over time.

How did the fund perform, and what factors had the biggest influence on performance?

The fund finished a tumultuous December roughly flat, but weakness in October and November resulted in a quarterly loss of 5.89%.

Our directional strategies were the primary detractor, as exposure to stocks and commodities worked against performance. On the plus side, exposure to rate-sensitive fixed income contributed and partially offset the overall negative result of our directional strategies, particularly in December.

Non-directional strategies also detracted, but less so than directional strategies. Our equity mean-reversion strategy, which seeks to capitalize on short-term fluctuations in the S&P 500, was caught on the wrong side of long and short trades. Other alternative-beta strategies, such as volatility carry and cross-asset trend-following, also hampered performance. Volatility carry attempts to capitalize on differences in implied versus realized stock market volatility. Cross-asset trend-following is a quantitative strategy that seeks to identify asset classes exhibiting favorable characteristics across stocks, bonds, commodities, and currencies.

In aggregate, our equity-selection alpha strategies — which are market-neutral trades designed to perform independently of global stock markets — and our currency alpha strategies were further dampeners on the fund's performance. By contrast, regional fixed-income long/short positions were one area of strength within our non-directional strategies, albeit not enough to compensate for weakness elsewhere.

What is your near-term outlook?

As we enter 2019, we have a positive view toward energy and commodities generally, and are tactically bullish on stocks.

Looking first at energy, we think the downturn in oil prices that occurred during the fourth quarter was overdone. In our view, two key developments unsettled the market. In October, the Trump administration placed restrictions on other countries' ability to receive oil from Iran, threatening to completely halt that country's oil exports. Then in November, the U.S. made deals authorizing exemptions to eight countries, without disclosing the terms. As a result, investors concluded that the supply disruption wasn't likely to be as bad as feared. At the same time, energy production in North America rose substantially, driven by U.S. shale producers.

As 2019 unfolds, we think rising global demand combined with production cuts by Saudi Arabia and other members of the Organization of Petroleum Exporting Countries [OPEC], as well as Russia, may help oil prices rebound.

Turning to stocks, we think the fourth-quarter sell-off was an overreaction to global economic factors. In late December, we began to see signs that indicated investor capitulation, in our view. Examples included negative sentiment among retail investors and asset flows shifting from stocks and high-yield bonds to money market funds. Given that we do not believe a recession in the United States is likely during 2019, these signs of capitulation bolstered our tactically bullish view. We think the market downturn produced more appealing valuations across a broad range of stocks and industry groups. We also believe companies may resume buying back shares, which, in our view, would provide a boost to market performance.

Outside the United States, we think stocks in Japan appear attractive. In our view, government policy has led to improved corporate behavior, such as returning capital to shareholders in the form of dividends and share buybacks. Corporations also have a greater focus on profit margins and return on equity. We believe these developments may be underappreciated by the market. What's more, we think valuations of Japanese equities are quite attractive.

How have you positioned the fund in light of this outlook?

During the quarter, we sought to capitalize on market weakness by increasing the fund's exposure to stocks and commodities, moving to overweight allocations in both asset classes. We also augmented the fund's exposure to credit risk, but our allocation there remains neutral.

We maintained slightly underweight exposure to interest-rate risk. We think bond yields may drift higher during 2019, as interest rates continue to move toward levels that are historically more normal at this late stage of the economic cycle.

We added several new non-directional strategies to the portfolio in 2018, including strategies in equity and fixed-income selection, regional fixed income, commodity alpha, and alternative beta. As of quarter-end, the fund is tilted toward directional risk, led by strategies that seek to capitalize on stocks and commodities.

Putnam Multi-Asset Absolute Return Fund (PDMYX)

Annualized total return performance as of 12/31/18

Class Y shares *Inception 12/23/08*	**Net asset value**	**ICE BofAML U.S. Treasury Bill Index**
Last quarter	–5.89%	0.58%
1 year	–9.04	1.88
3 years	1.03	1.02
5 years	1.55	0.64
Life of fund	4.02	0.40

Total expense ratio: 0.83%
What you pay: 0.82%

Returns for periods of less than one year are not annualized.

"What you pay" reflects Putnam Management's decision to contractually limit expenses through 4/30/19.

Current performance may be lower or higher than the quoted past performance, which cannot guarantee future results. Share price, principal value, and return will vary, and you may have a gain or a loss when you sell your shares. Performance assumes reinvestment of distributions and does not account for taxes. For the most recent month-end performance, please visit putnam.com. For a portion of the periods, the fund may have had expense limitations, without which returns would have been lower. Class Y shares are generally only available for corporate and institutional clients and have no initial sales charge.

The ICE BofAML U.S. Treasury Bill Index is an unmanaged index that tracks the performance of U.S. dollar-denominated U.S. Treasury bills publicly issued in the U.S. domestic market. Qualifying securities must have a remaining term of at least one month to final maturity and a minimum amount outstanding of $1 billion. You cannot invest directly in an index.

The S&P GSCI Index is a composite index of commodity sector returns that represents a broadly diversified, unleveraged, long-only position in commodity futures.

The ICE BofAML 7-10 Year U.S. Treasury Index is an unmanaged index that tracks the performance of the direct sovereign debt of the U.S. Government having a maturity of at least seven years and less than 10 years.

The MSCI EAFE Index (ND) is an unmanaged index of equity securities from developed countries in Western Europe, the Far East, and Australasia.

The MSCI Emerging Markets Index (ND) is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

The FTSE World Government Bond Index (WGBI) measures the performance of fixed-rate, local-currency, investment-grade sovereign bonds. You cannot invest directly in an index.

The Bloomberg (BBG) Barclays U.S. Aggregate Bond Index is an unmanaged index of U.S. investment-grade fixed-income securities.

The S&P GSCI Light Energy Index is a sub-index of the S&P GSCI and reflects investment performance in the energy commodity market.

For informational purposes only. Not an investment recommendation.

The views and opinions expressed are those of the portfolio managers as of December 31, 2018, are subject to change with market conditions, and are not meant as investment advice. All performance and economic information is historical and is not indicative of future results.

The fund is not intended to outperform stocks and bonds during strong market rallies.

Consider these risks before investing: Allocation of assets among asset classes may hurt performance. The value of stocks and bonds in the fund's portfolio may fall or fail to rise over extended periods of time for a variety of reasons, including general financial market conditions, changing market perceptions (including, in the case of bonds, perceptions about the risk of default and expectations about monetary policy or interest rates), changes in government intervention in the financial markets, and factors related to a specific issuer or industry. These and other factors may also lead to increased volatility and reduced liquidity in the fund's portfolio holdings. Growth stocks may be more susceptible to earnings disappointments, and value stocks may fail to rebound. Bond investments are subject to interest-rate risk (the risk of bond prices falling if interest rates rise) and credit risk (the risk of an issuer defaulting on interest or principal payments). Interest-rate risk is greater for longer-term bonds, and credit risk is greater for below-investment-grade bonds. Unlike bonds, funds that invest in bonds have fees and expenses. Lower-rated bonds may offer higher yields in return for more risk. Funds that invest in government securities are not guaranteed. Mortgage-backed securities are subject to prepayment risk and the risk that they may increase in value less when interest rates decline and decline in value more when interest rates rise. International investing involves currency, economic, and political risks. Emerging-market securities have illiquidity and volatility risks. Our alpha strategy may lose money or not earn a return sufficient to cover associated trading and other costs. Our use of leverage obtained through derivatives increases these risks by increasing investment exposure. Risks associated with derivatives include increased investment exposure (which may be considered leverage) and, in the case of over-the-counter instruments, the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations. The fund's efforts to produce lower-volatility returns may not be successful and may make it more difficult at times for the fund to achieve its targeted return. Under certain market conditions, the fund may accept greater-than-typical volatility to seek its targeted return. The fund may not achieve its goal, and it is not intended to be a complete investment program. You can lose money by investing in the fund. The fund's prospectus lists additional risks.

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Request a prospectus or summary prospectus from your financial representative or by calling 1-800-225-1581. The prospectus includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

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